VISIT…

- **Introduction to Shorting: DTU Short Trading Rules & Tips**

Main Points:

- If you're like most traders, you're uncomfortable with the idea of shorting. Traditional stock investors are trained to think that "if I buy a stock and hold it long enough it'll surely go up". If you bought and held from the last few months of 1999 til now you're in the red.
- You may be reading this thinking to yourself, "well I'll read what he has to say but I probably won't ever short anything". Right?
- By the time you're done with this module, I hope you'll learn to recognize and see the profitable opportunities that are available to you by adding short selling to your arsenal of trading techniques.
- There is very little out there on shorting, only 1-2 books, an audio and a video. That's it. Yet professionals are always used to selling short. So should you. It's like "working an order the other way around". Uncomfortable at first, but it still works. I'll give you what you need to know.
- Here's an example (from my mgmt. training days): I want you to cross your arms, folded across your chest, right now as you're reading this. Go ahead. Ok, now unfold them and cross them the other way, putting your right forearm across your left one. It's uncomfortable, right? But, both ways are equally successful at keeping your arms folded on your chest. Change is uncomfortable for many, but necessary. Shorting is the same.
- If you've ever bought stock long on margin, you're doing the same thing a short seller does...borrowing something you don't have, with the intention of paying for it later.
- Shorting is for more experienced traders, eg at least 6 months to a year full-time experience, or 2 years + occasional swing trading experience.
- I will show you the best ways to short stocks in this module, using current examples, and information not available anywhere else.
- Take a look at our Short Trading Rules to Live By below, and memorize them if you plan on shorting. They should help you immensely, in learning how to trade the short side.
- Do not underestimate the value of shorting, or avoid it merely because it's not what you're used to. That's like not trying Chinese food because you've never eaten it before. Expand your menu of trading choices to include shorting as a common and viable way of trading.
- If you're wrong in a stock going long, consider not only stopping out but reversing your position into a short at the right time as well... same thing for winning long positions that are reversing, you can sell it out at a profit, then enter a short and ride it down to an intraday support level, covering to make another nice profit.
- Don't just ride the curve up, make money on the selling too.. why not? Once you become more familiar with it, shorting is a handy way to make a lot of money. If you had shorted all the January tops you'd be much wealthier than losing buy-n-holders are, who are sitting in red positions waiting for a bounce. Right?

Short Selling quick intro:

What is shorting? Shorting is simply selling a stock first, then buying. You're borrowing the shares from your broker to sell to someone elso at one price, in the expectation that the stock's price will decline from where you bought it. You then buy the stock on the open market later, so you can repay the broker the shares you borrowed from him.

What's different about shorting? We'll cover the "uptick rule" in the next lesson, basically it means you've got to enter your order (to sell) only when the stock's price has just had a positive transaction, eg the arrow in your stock minder shows a green up arrow, not a red down arrow. This means you may have to try to enter a short order several times to catch the uptick.

Isn't shorting dangerous and risky? The only risk is that if the stock price goes up there's a lot of possible risk if you can't keep a stop loss. A long trade of 100 RNWK bought at 41 means you have a $4100 investment at stake, it could conceivably drop to zero, in which case you'd lose $4100. If you shorted RNWK at 41 it could run to 210, and you'd owe your broker the difference, or (210-41=169) or $16900. If you're not good about taking stops, then you shouldn't ever short. Or go long, for that matter. Taking stop losses is especially important in shorting.

DTU's SHORT SELLING 'RULES TO LIVE BY':

Rule #1: Never hold short positions overnight

Why this rule? Because I want to minimize your risk to upside overnight gaps. If good

news comes out, or the futures are way up, causing a lot of gaps up, your short could cost you a lot of money.

I recommend only intraday shorting, never ever "swing short" in my opinion. The risk:reward may not be as good. Of course, many traders do just fine with 1-2 week short positions, but it's not a trading style I'm comfortable with, I wouldn't be able to sleep, wondering if good news will cause my short to gap up against me the next morning.

Look at stocks like CIEN CNXT etc. with recent large gaps. Shorts would be in a bad position if they held shorts overnight.

The rule of "never take home a losing position" is especially true of shorts. If the stock goes out strong, it's likely to gap up or have a next strong day, so, don't take it home short. It just isn't worth the risk.

Rule #2: The best time to short is on an open gap up of over 8%

We will cover this with many chart screensnaps and video clips in the later part of the module. Open gaps up are the best short candidates, just as open gaps down are the best long candidates, if it happens on strong volume and you see sellers begin to appear.

The larger the gap up is, the more likely a retracement back down will happen. Think about it, if you had a position in KLAC from 53 and it gapped up to 62, wouldn't you want to sell it on the open? Most other people would too, so this is an idea time to sell stock as well, shorting it, then covering at the fibonacci retracements, eg down 38% from the high, roughly a third down.

If you see a stock gap up over 40-50% (rare, but it happens), look to short it as well. This is one of the valuable parts of looking at the "Day's Gainers" lists early in the morning... even as late as 10:00... look for the stock to begin selling off into the gap up and fire off a short, using a stop at the previous high for the day.

Rule #3: The next best time to short is after a stock has lost a key support level and is making a new low for the day

If a stock is in a technical downtrend, eg a series of lower lows and lower highs, you will want to short the next lower high after it's lost a key support level, particularly a decade number.

For example, if RNWK loses 40, you'd look to short at 39 3/4, with a cover stop loss at 40 1/4 or so. You'd have an exit target of 37-38 1/2.

This play is good for the first trading hour in the morning, as well as lunch and afternoon selling pressure. Look to short the second time a new low of day is hit. We'll show lots of annotated chart example in future lessons. Use a two-day chart here too, eg always look to short a new 2-day low, and buy a new 2-day high. Many professionals use this technique as well. I always use 2-day 3min candle, intraday 1-min stochastic, and 10day 15 min candle charts to trade.

Always pay attention to the sector and broad market indexes: short stocks on weak days, buy stock on strong days. Do not fade (try to outguess a reversal in) the overall market trend! Buy strong stocks, sell/short weak stocks.

Rule #4: Other good times to short are the 10am reversal of an uptrend and at 12:00 on lunch weakness

10am tops reversal shorts: This is your chance to profit from the classic "gap and trap" play that market makers like to do. On stocks that put in a 10am high (that is Not a 2-day high), you may want to short it if it starts to get selling in a "microdowntrend". This one is a bit riskier, so be sure to put a cover stop loss at the immediate previous high.

Lunch weakness shorts: A slightly better time to short is when the market starts to drift downwards during the 11:30 to 1:30 slow lunchtime, since this is when many market makers like to bully stocks down so they can get a low of day price to sell back into afternoon buyers. So, shorting a stock that's making a new low of the day at around 12:00 is usually a good time to short.

Rule #5: It is too dangerous to try and "catch a rising knife" and short a momentum stock's top.

Okay, 'fess up - how many of you have been cut trying to catch a bottom for a stock you think is going to bounce up? We've all done it. Shorting momentum stocks is the same exact thing, in reverse.

Do not ever, repeat ever! try to predict the top of a strong stock that has a lot of buyers in it. When demand exceeds supply, price goes up. It is difficult to nail the exact top of stocks that rise, say, 5-10% in 20 minutes on a hot news story.

This, unfortunately, is how many traders try to get started with shorting, and they get burned more often than they correctly guess the top. We want to use technical analysis, LII and other indicators to trade, not guessing.

Once you understand true market dynamics, you'll realize that you don't want to try and guess a top for a hot stock. You may get a short off on a wiggle, right before the stock explodes to a new high. Shorts are often "squeezed" here, as everyone rushes to cover their short positions. The market makers step off, and the price runs. These are good opportunities to get long, when a new high is made. Do not try to short momentum stocks unless you're very fast, have very tight scalping-type stops (eg 1/4 point absolute max, 1/8 better). An exception might be if the stock is up a ridiculous amount for the day, say over 80%.. eg I nailed the XING top at +92%, but those are very rare times. 99% of the time you'll want to avoid shorting momentum runners.

Rule #6: Use a cover stop loss at the most recent intraday reversal price

Let's say you short CSCO after it loses 60 support, making a new low for the day. You get the short off at 59 3/4. It wiggles up a bit to 59 7/8, drops down to 59 1/4, then runs back up to 60, then goes to 60 1/4 and beyond.

What's the proper way to have managed this trade? Your cover stop loss should be a bit over at the support level that the stock lost that caused you to enter the short in the first place. If you shorted because you think 60 was a key support level that was lost, and your reason for entering the trade is proved wrong, eg they take it back up over the 60, then you'd want to cover right over 60, at 60 1/4 max.

Rule #7: As with all daytrading stocks, make sure to only short stocks trading over 800K average daily volume. Check that your broker has stock available to short ahead of time.

These should be common sense, but they're worth noting nonetheless. As with all intraday trading you, **volume is your insurance**, and helps you take your stops quickly and at a good price. Only trade stocks with an average daily volume of over 800,000 shares.

If you're trading a thin stock, you may not get filled til way past your stop, costing you more than you wanted to spend, in the event that you're wrong about the price direction.

A second note: check with your broker to make sure shares are available to short. You don't want to correctly identify where to short, then try to enter the order and get a "shares not available" message. Also note that all shorts are done in your margin account, and that stocks that are non-marginable are not shortable either (including under-$5 stocks).

Okay, let's move on to some chart patterns and examples...

- **Open Shorts: The Safest and Best Short Play**

Main Points:

- Shorting stocks that **have a large gap up** on the open on news are often profitable. You want to avoid shorting good earnings release gaps and buyout gaps though.
- You should look to short overreactions to news (eg gaps up over 15%) on high volume (eg over 30K shares premarket) within the first 10 minutes or so of the market open.
- The other way to short gaps is to short a stock that makes a **small gap down premarket and continues selling after the open**, eg 1/4-1/2 point, and loses a 2-day support level, making new lows. (eg ALTR closes at 48 3/4 near the low of the day, the next day's premarket trading at 48 1/4, it loses 47 3/4 on the open at 9:30, short it here with a cover stop at 48 and an exit target of 5/8 to 1 1/2 points etc.)
- As always, it's a good idea to place a close short cover stop loss right above the exact open price as well, in case buyers keep coming into the stock.
- In general, you want to see a bit of a downtrend on the gap occurs from where the stock was trading premarket. For example, if it closed at 36 1/2 the night before but gapped to 40 3/4 premarket the following day on news of a new contract being won, then sells down to 39 7/8 by the time the market opens at 9:30, you'd want to consider firing off a short on the open (using a cover stop loss at 40 1/8) and an exit target of roughly 1/3 the retracement, at 38 1/2.
- You can also short minor gaps down, as well as major gaps up, as follows:
- Let's say a stock closed at 28.... near it's low of the day. Then the next day it gaps down a bit to 27 3/4. You might want to fire off a short at the market open (9:30-9:35) with a cover stop loss at 28 1/8. You might look to cover it near a 10-day support level, or, use a trailing cover stop about 1/4 behind where the stock is currently trading at.
- Do not short major gaps down on the open. They tend to attract buyers.
- You could short a major gap down stock if it's still selling off as of 10:15 am or so.... just don't try to short big gap down stock... the "trade potential" is largely gone on the short side, as people who were short from earlier will probably look to cover their shorts (these are the "dead cat bounces" that you can scalp on the long side oftentimes).
- Take a minute to review Mod1Lesson10 and the next lesson as well, click here, for some basic gap info as well.
- Let's look at a few charts here to look at examples of shorting on the open. Again, don't short premarket... but, look for short opportunities within the first 5-10 minutes from 9:30-9:40, for these chart patterns below:

How to Trade Open Shorts

Here's a perfect example of an open short play, for a stock called GALT that gapped up over 30% premarket on Oct. 17th.

The 2-day chart to the right shows the stock closed at right over 30, and doesn't trade on much volume. After a positive news story came out, the stock gapped up to 43 premarket on high volume (over 100K shares had traded before 9:30am on 10/17).

You do Not short stocks that gap up on good earnings, in general, eg MSFT gapped up over 10% and kept going up after the open. Be selective, and **first "wait for the stock to lose a key support level before shorting it on the open**. This is the most important thing to realize about open shorts. You do Not just short it because it's up 30%, it could run to +42% before topping. Let the chart tell you the story, short only after it loses a support level.

In our Trading the Open live trading room, I advised traders to "**Short GALT if it loses**

40 support, say at 39 3/4" (exact quote). I advised them to cover around 36 or so (fibo retracement). This was a great trade! Hope this makes sense. 40 (decade number) is where I pegged support. It could have reversed above 36, so that's where we covered (it's ok that we didnt' get the full range of the short, we're happy to take almost 4 sticks (points) on a $40 stock!

	10:00	11:00
10/16/00	10/17/00	

Let's look at some more examples...

Ebay had ran up to 60 and consolidated the day before here (Oct 17, 2000), right before the close. It ran up a bit more on the open here, consolidated a bit more for the first half hour, then losed 60 support (twice, a double bottom).

We would have been stopped out for a - 3/8 or so loss the first time, but on our re-short (2nd time it lost 60), we are in for a nice win as it dropped to 59, consolidated, and sold off down to 55, where we cover, for a + 4 3/4 win.

Note the key when we're wrong, if it "shakes us out", like it did the first time, is to keep the cover stop loss small, say 3/8 to 1/2 point max.

This example shows you about breakdowns below consolidation (choppy undecided) trading zones that last for 5-10 minutes before the trend is re-established one way or the other, on open gaps up.

Here's Oct. 17th KLAC, a semiconductor company - notitce we could have got an open short off at 32 on the open, if we were fast... however I like to wait til it loses a key support level, my favorites are decade numbers since level 2 tends to get thicker there, as the market makers have a lot of stop buy and sell limit orders there from the public investors that they have to fill.

So, we see a bit of consolidation before the downwards march continues, we fire off our short right under 30, at 29 3/4 (with a cover stop at 30).. We cover 1/2 the position at 29 (trailing stop at 29 1/2) and the balance at 27 1/2, for another 2 1/4 points win.

Remember, you can add to and sell off your positions in pieces, a common pro trading technique, eg short 400 at 29 3/4, cover 200 at 29, wait and cover the remaining 200 at 27 1/2. Your trades do not need to be "all or nothing", rather use dynamic position sizing depending on the price action to get the best overall trade. This is how market makers trade, you should try it out yourself as well.

More Tips & Guidelines on How to Make Winning OPEN SHORT Trades:

Keep these pro techniques in mind for playing open shorts:

- Keep in mind the **reason** for the open short (why did they gap it up?). Be more cautious about shorting earnings plays than you are about shorting news-type plays.

- Always always keep **tight stops** on your shorts. Because of the effect of **"short squeezes"**, eg shorts trying to cover in a panic if the price starts to go up, you need to be prepared to cover quickly. Never short without a DAT broker (don't daytrade w/o a DAT broker, for that matter). Cover with market buy orders (or SOES limit/ISLD).

- **The higher the open gap is, the more likely it is to attract sellers**, which makes for a better short play. Don't short a stock that gaps up 3-5%, for example (we look to play thse on the long side, if they make a new 2-day high or are making a cup pattern). Watch your "daily % gainers" list and look to short stocks that are trading over 400K volume or so that have gapped up over 15-30%. If a stock has gapped up over 50% it will almost always attract sellers, so it's a matter of "when not if" to short it, if shares are available to short. Check with your broker ahead of time that morning to see if they have shares to short. **If your broker has a lousy (small) list of stocks that are available to short, switch brokers**.

- **Use Level II and Time & Sales to help time your entries for shorts more than for longs.** We are still chart-pattern based trading using technical analyses, of course, but because of the uptick rule and the dynamics involved in shorting you should pay **closer attention to level 2 support/resistance** for shorts than for longs. The t&s is more important of course, that's your navigation for the trade (the "tradewinds").

- **Use Fibonacci retracements to help you identify your targets for where you should cover** your open short trades. In the GALT example above, we don't expect more than 36 out of the trade since that's near a fibo line. Your open gaps up will almost never close the entire gap, I look to get out at 1/3 to 1/2 of the retracement range.

Time of day patterns for best short selling: finding the best trading opportunities

Main Points:

- Becoming successful at timing your trades is important to your success.
- In this lesson, we will look at some of the time of day patterns that you should be aware of to short stocks effectively.
- By gaining familiarity with the time-of-day patterns that set themselves up for good short opportunities, you can become more effective in "timing your trades" to be in sync with the professional money flow.
- Remember to keep an eye on the broad market indicators as always, an eye on the Nasdaq TRIN, the COMPQ, and your sector charts, to confirm the reversals and time-of-day pivots as they occur in the market each day.
- In time, you will hopefully become more practiced, more "on time" with the market's many pivots and become better able to navigate the directional changes as they occur.
- Your primary goal by the time you complete this lesson is to be able to a) anticipate time of day patterns that yield profitable short trades b) be able to recognize these time-based pivots and reversals when they occur and c) be able to execute short trades more successfully as a result of now "knowing what to look for" in your short trades.
- Remember that timing takes much practice, and is both difficult to learn and time-consuming to practice. This is why market-watching a core bastket of 5-8 key stocks for weeks, months on end, during at least the first 2 hours of each trading day, is so critical to your development as a trader.
- As a new trader, I used to enter trades late, still looking for good movement after the first, most powerful move, had been made. In time, I learned to jump on the first move more consistently and accurately. This takes a lot of time to develop; the more 1-minute charts you watch, the better you should get at this crucial trading skill.
- Each trading day is a mini-world in itself, you need to not apply blanket rules or your expectations to any one day, rather, you need to be flexible and trade "what the market is telling you" for each separate session.

- Paper trading, or trading 100-share trades, for many months, is a great way to learn the intricacies of trading without exposing your capital to much risk. This is a good way to learn shorting, by paper shorting at least 6 months initially before doing live trades.

- Let's take a look at some of the timing patterns I've discovered that help uncover what should become consistent, profitable trading opportunities.

Time of Day Patterns for Shorting Nasdaq Stocks

Here's a brief summary, we will illustrate all of these with recent chart patterns, from Feb 2001, below:

EARLY PLAYS: We've already discussed the "short an open gap up" when there's a bear cup reversal that you can see premarket. The other early play is a bear cup reversal occurring after the open..

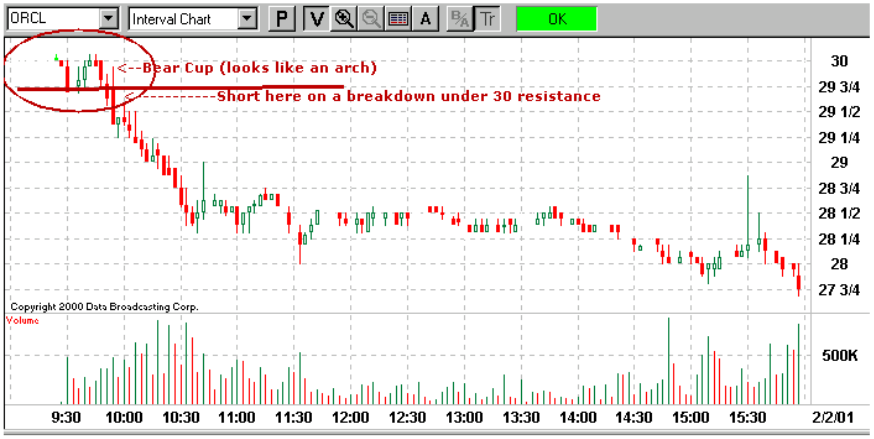
LUNCH PLAYS: Market makers often take a lunch break (hey, they're only human too, contrary to popular perception :). And stocks often drift down from 11:30 til 12:45 or so. Leisurely shorts can often be entered in this time frame as well.

LATE SESSION PLAYS: Although I rarely or never play the afternoon session, you can look for short opportunities late in the trading day on days where a) the compq is making new 2-day lows after 2pm or b) the market has run up considerably until 3pm, and profit-taking is happening.

Bear Cup Breakdowns on the Open:

In shorting bear cups right after 9:30, as with open gaps up, you look for an arch, eg the stock gets buyers on the open at 9:30, goes up to meet resistance, and starts to fall. The key is, you don't guess at the top, you wait til it makes a new low of the day, and short under the breakdown.

These are best if they are making a new 2-day low as well (in this example, let's say ORCL traded 30-31 1/2 on the previous day... today, it opened at 29 3/4 on the open, traded to 30 decade resistance, then sold off again, the short is at 29 5/8.



Patterns for 10am Shorts:

Sometimes a stock will chop around til around 10am, at which time it makes a breakout to the downside (or upside).

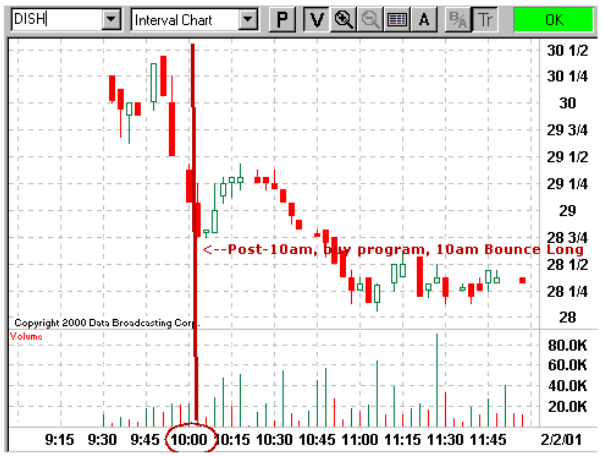
For shorts, we can look to 10am as a good time; often the traders in a stock will decide whether to bid it up or sell it off at around 10am.

This is a good time to look for short entries, at right before 10am, to prepare to short a breakdown.

As you can see from this example, the stock broke down early at 9:50 or so, then got a 10am bounce, before continuing down.

This illustrates the need to always keep tight stop losses; eg if we short at 29 5/8 or so, and it drops to 29 3/4 then starts to bounce, we cover soon with a small 1/2 point profit or so, we don't wait for the stock to go back up to our original short entry point.

In the current market, trading wins over 5/8 point on $20-$60 stocks are fine to take, they are the "base hits" that are our bread and butter... of course the home run + 1 1/4 type trades are great to get as well.



Shorting Lunch Weakness with the mms:

Oftentimes it is good to look to enter new short positions from around 11:30 or noon until 1pm or later, as stocks will often drift downwards over the lunch hour, until the mm's return from lunch and volume/volatility returns to the market. These are longer daytrades, usually taking 15 minutes to an hour or more to complete round trip.

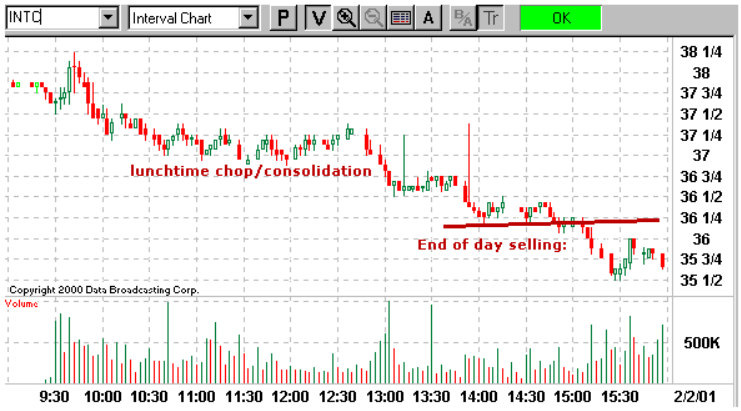
Here's a perfect short example: AMAT is stairstepping down in a classic downtrend: lower lows and lower highs throughout the morning.

Late Session End of Day Shorts:

Finally, we can look at late end-of-day selling. There's two time zones to be aware of, one is from 2-3:30 or so, the other is during the close, from 3:30 til 4pm.

The best is to look for bear cup breakdowns during 2-3:30, as selling continues.

Often you'll see some volatility at 3pm when the bond market closes; also, you may see end of day tanking Or short covering, so, careful holding any short positions post-3:30pm.



Module Five

Shorting Skills for Active Traders:

PREVIOUS NEXT

Back to MODULE 5

- **Premarket indications for shorting opportunities: chart patterns, news/earning**

Main Points:

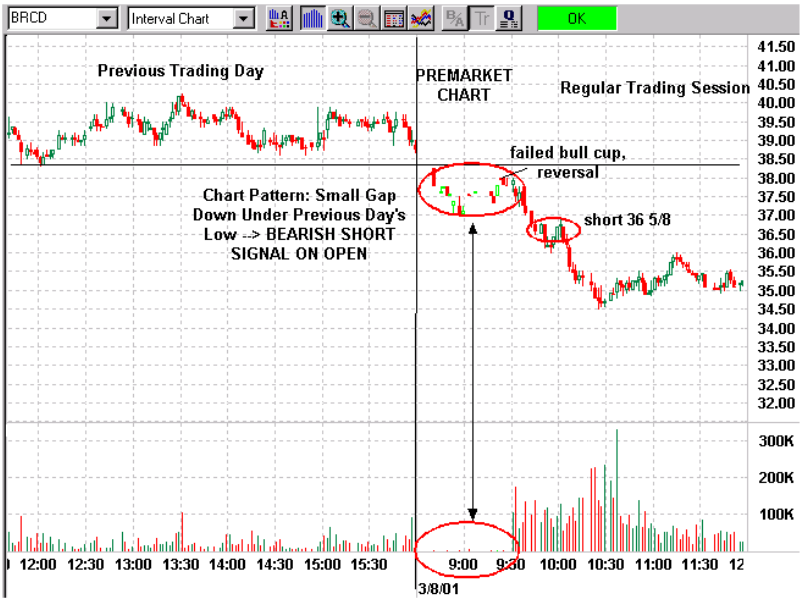
- We've already discussed how to look for large premarket gaps up, over 8-15%, that are getting selling on the open (bear cups) as being the best short opportunity. Now let's look at a few more.
- Premarket activity is a good leading indicator about the overall strength/weakness of a stock when the gap activity is less than 5%.
- I've pulled together a handful of example charts for this lesson to help you see how to use premarket charting to correctly identify short candidates.
- You need to have a charting software data feed service (like esignal.com :) that has premarket chart ability in order to daytrade effectively. There's no reason to be "blind" each morning in the premarket, when you can have charts to help you see double tops, cup breakouts and reversals.
- We do not ever enter new positions in the premarket. This is because our volume is very low. Speaking of volume, you only want to screen for stocks that have over 20-30K minumum volume by around 9:10 am. If a stock has gapped up a lot or down on just 12-15K volume, for instance, you don't want to touch it - yet.
- We are looking for continuations & reversals on the open from premarket chart patterns. The stock will do one of three things: stay flat, go up, or go down, right? We want to see if there's significant movement up or down through a good technical entry point.
- I tend to like to short stocks that are making new 2-day lows at around 5/8 below the whole number that was the previous low/support level. You will see this in the charts below.
- Charts let you see the impact of news, earnings releases, and anything else, so we use chart patterns to trade with. We do not guess at what news/earnings will mean for the price of the stock - ever. If we did that, we'd be investors. (perish the thought!)

Small Premarket Gap Down Under Previous Day's Low

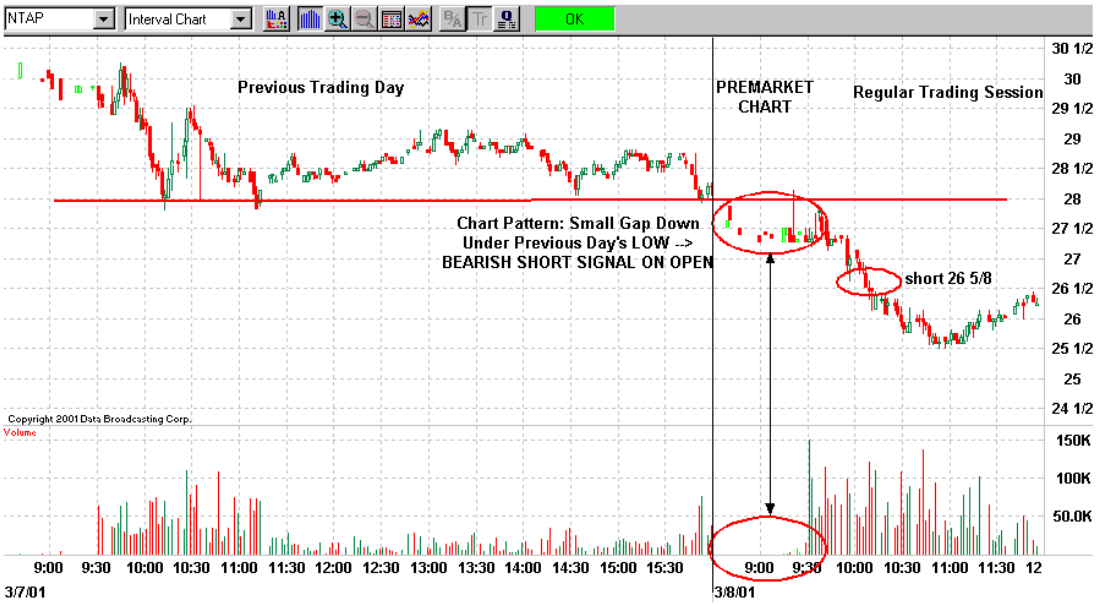
Here's a good example of a premarket double top failure in BRCD that continues on down.

Note that we do not short on the open, we instead wait for the premarket pattern to make a new low, and enter the short at 36 5/8.

This is a classic "short the 2-day low breakdown" after a weak opening in the stock.



Below in NTAP - what do you see? I always draw the technical low/high/2-day lines to help you see what I'm looking at as well. In NTAP we see support at 28 in the previous trading day, a weak open with a small gap down, and a breakdown later in the morning on heavy selling volume. We short in the area of 26 5/8 (under the 27 whole number support) and cover out in the high 25s as our cover stop gets taken out on the way up after 11am.



Larger Premarket Gaps Down Under Previous Day's Low

Remember we typically start looking for bounces in stocks that gap down more than 8-15%, right?

One exception to this is if the stock gaps down to retest the immediate day prior's low, in this case to the right, TXCC, that was under 20, at the 19 3/4.

One good thing about these shorts is that you can easily see where your cover stop loss would be, eg the 19 3/4 line.

So, a short on the open, around 19 5/8, would let you cover as low as 18 5/8 or so before a bounce takes out our trailing cover stop.

For these types of patterns, make sure you have confirming indicators that shorting is the right move, eg your sector charts all gap down a bit on the open, the COMPQ is making or near a 2-day low, or is selling off after a large gap up, etc.

Finally, we have SUNW, a stock like INTC MSFT I rarely trade since volatility is low.

We do have a good pattern to work with today, a "failed bull cup" in the premarket, you can see the price tested 21 3/4 a couple of times before losing it, we short on a breakdown, new low Under the Premarket Low (that's important, make note of it) that's also under the previous day's low.

In this case, we could nibble +1/2 on a short under the 21 1/2 short on the open, cover around 21.

Types of short plays: lunch weakness shorts, morning top shorts, momentum shorts.

Main Points:

- We are covering a number of different types of short plays in the lessons in this module so that you can become completely familar with where the entries are.
- There are many short opportunities in each trading day, and you are encouraged to learn how to play these as well as our long plays.
- Most traders never short - this is a mistake.
- New traders try to short momentum runners - this is also a mistake.
- Learn to short 2-day breakdown lows using bear cup patterns etc. as we mention in other lessons as well.
- Pattern recognition is one key to successful daytrading.
- By showing you many examples of annotated chart patterns for these short plays, I am hopeful that you can learn which shorts are likely to work out, and which types to avoid, based on your trading experience.
- For example, new traders [less than 1 year fulltime experience] should never go against the trend and try to short tops, of momentum runners.
- It is always important to remember to use a cover stop loss on shorts, just as in long trades... eg if you're wrong, get out with no greater than a -3/8 loss, ever.
- In general, I like to short under a whole number, say at the 3/4 or 5/8, and use the whole number above my short entry as the max stop loss exit to cover.

Major Types of Short Daytrading Plays

Here's a brief summary, we will illustrate all of these with recent chart patterns, below:

(reminder) 2-DAY LOW BREAKDOWN SHORTS: These are the best shorts, the inverse of our long 2-day breakout high plays. Simply look for a stock to be making a new low below the previous days low, and short under the whole number below this area.

LUNCH WEAKNESS SHORTS: As we mentioned, look for weakness after 11:30-noon, til around 1 or 2... stocks will often sell down during this time frame, making for good shorts. Beware of 12:30 and 2pm long reversals, on rare occasions.

MORNING TOP SHORTS: Often you will see stocks put in a top at around 10am. This is a good time to look for reversals and enter shorts for experienced traders, as the stock makes a bear cup.

MOMENTUM SHORTS: For experienced traders only, these are worth learning as well - you need to be very experienced in reading time &sales to even consider these. These are following multipoint runs up, and are shorts initiated after selling below a whole number has occurred, eg you see a "bear cup" pattern and have a t&s confirmation. The opposite of "catching a falling knife", these are generally not recommended... at least, not unless you're skilled at spotting reversals..

2-day Low Breakdown Short

As a brief reminder, these are the best shorts to look for, in the order of "likelihood of them working out correctly" for you. I am mentioning the other types below to broaden your vocabulary. Remember, losing a 2-day support level usually works out for a short. In this case, we'd take a stop even on the first attempt at 10, and made a good 1-point run on the lunch 2-day breakdown as indicated below:

Lunch Weakness Short

Here's another examples of a lunch weakness short on an intraday chart, PWER losing support at 35.

We enter the short at, say the 34 5/8, and trail a cover stop down til we're out at the 33 1/4 or so, for a +1 3/8 on it.

Lunchtime seldom gets new buyers, the market is often choppy and/or weak.

If it's just chopping around in a tight consolidation, or trading range, then do not trade it.

If, however, the stock loses a key support level during lunch (again, preferably a 2-day support), then you can look to enter a short, again with a 3/8 max stop loss in it, and look to cover with profits by 1-2pm.

Shorting the Morning 10am Top

CAUTION: Experienced traders only

This is for experienced traders only.

You can look to catch a reversal at around 10am, where many stocks put in a day's high (or at least, the morning high), on weak or choppy days.

Of course, you would not short at 10am if the whole market is running, making new 2-day highs, the TRINQ is under 1 etc etc... use common sense.

The 10am time frame is important to the morning session, and is when the first strong trend develops, after the market's chopped around in it's 9:30-10 amd 10-minute reversals.

Look to exit open longs near 10am at the first sign of weakness, using a close trailing stop (eg 1/8 to 1/4) if in long, and possible reverse to short on any weakness and bear cup pattern.

Shorting Momentum Runners (Not Advised for most traders)

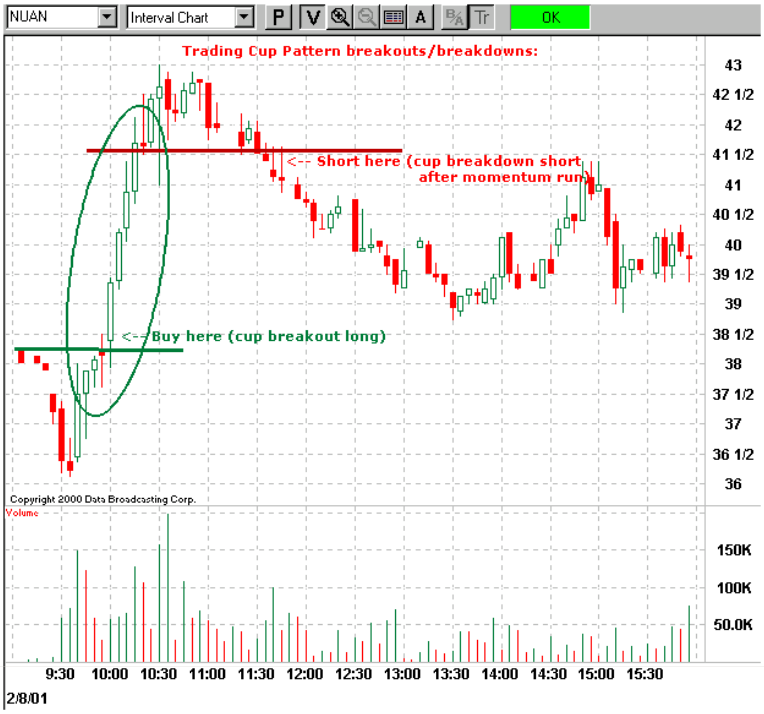
CAUTION: Experienced traders only

Finally, we will look at the type of trade I don't recommend for most traders... which is looking to short momentum runners... in fact I've spoken against this type of trade, since it is how most new traders get burned.

We can see a long buy on a bull cup breakout early in the stock... in this chart we'll look at the short entry off the top.

How would you ever know it wouldn't run to say 45 or 47?

That's the problem with this type of trade, same as the inverse, in buying long stocks that are tanking. A clue is a) multipoint run up b) high volume in the consolidation zone at 10:30, telling us a lot of stock is changing hands.. c) bear cup forming from 10:15-11:15 and d) finally, most important, a bear cup breakdown under the 41 1/2 at 11:30 into lunch weakness.... several factors telling us it may finally be time to consider shorting this one. Careful on these, and don't do them unless you're fast and good w/t&s.



Module Five

Shorting Skills for Active Traders:

◀PREVIOUS NEXT▶

Back to MODULE 5

- **TA for Shorting #1: Basic Short Chart Patterns: Identifying Intraday Sell Patterns**

Main Points:

- As with your long trades, being able to recognize successful shorting chart pattern setups can help you profit if you learn them.
- We will share patterns you will not see elsewhere, using high-percentage, easy to enter trading patterns.
- Remember to trade in the direction of the market, eg resist the temptation to short when the market is in a daily uptrend; short when things are "feeling down, like there's no buyers around", early enough though to avoid shorting at a bottom. TA and chart patterns are the key to doing this successfully.
- There are a number of correct short chart patterns illustrated and explained below. Please take a look at them and compare them to your core basket of trading stocks.
- Remember, we strongly suggest that you "get to know" from 5-30 stocks and their intraday patterns fairly well to be a successful day or swing traders.
- Do not jump into trades on stocks you've never heard of, unless you're experienced and successful with your core basket of trading stocks first... also avoid trading stocks under 800K average daily trading volume.
- Pattern recognition, eg "hey it's losing a 2-day support level here" is the key to effective shorting, along with keeping effective cover stop losses and using trailing stops.

How to Short Using 2-Day Support & Resistance Levels

Let's start with a big picture view. Once you've established that the market, the futures and your sector seem to have more sellers than buyers, eg the prices are in a technical downtrend, we want to focus on 2-day chart patterns.

The very first pattern I want you to learn is how to look at 2-day support and resistance levels. Remember, we buy 2-day breakouts, right? Well, the reverse is certainly true when it comes to selling, and shorting stock. You should enter a short when a stock is making a new 2-day low (except for shorting the bottom of a stock that's tanked already premarket, of course - that's an open gap down, for which we'd expect a bit of buying). Again, these are intraday plays, eg you're entering the short in the early part of the second day... you use 2-day charts for your intraday trading.

ALTR Short: Lost 2-day support level at 9:45

To the right we see an ALTR 2-day chart 10/5-10/6/2000.

First of all, what's the support level on 10/5/00 trading day? It was roughly **47**.

So you say to yourself, ok I'll look for a short in ALTR on 10/6 if it loses 47. Sure enough, the stock opened flat and started selling. The first short here could be near the open. (Note: typically I would enter shorts on the open (more for open gap up shorts) or around 10am).

Here, we see it got a bit of buying from 10-10:15, but couldn't get over 47 support (now resistance). This is a confirmation, and we have a successful short. Our cover stop loss? At right over 47, of course, say 47 1/4 or 47 3/8.

Where do we cover ALTR? I typically like to look to cover around 10:30, since I expect bounces, but in ALTR's case no buyers emerged. An initial short profit of 4-45 1/4 or + 1 3/4 could be had for a morning short, covering at 10:30, or, if you're patient you could have waited until 3:30 end of day short covers and covered around 43, for a +4 point gain on the short. (Note: we even called this short on the morning of 10/6 in our live tradingtheopen.com room beta test).

Traders' Plays - What to look for in 2-day support and resistance level short trades:

- Identify the 2-day low/support level for the stock
- Look to enter a short from 9:45-10am when the stock is making a new 2-day low.
- Look to make your initial cover at around 10:30 or so, be cautious about staying short at this time.
- Use trailing stops to lock in profits, and look to cover shorts quickly, so you do not get stuck in a "short squeeze"... which means, make sure you're already set up with a fast order routing method, eg ISLD ecn or SOES limit buy order.

Self-Test: Using two-day support for an intraday EBAY short:

- Identify the 2-day low/support level for EBAY
- What's your "short signal on 10/6/00?
- Where should your cover stop loss be located?
- Where would you look to exit with profit in this trade (hint: always always cover shorts before 3:30, since you will have an end of day short cover rally most of the time).

Answer: EBAY made a new 2-day low when it started tanking on 10/6 and lost 62 1/2. Covering by 10:30 or so at 58

1/2 would give you a +4 point profit on this short. Covering towards the end of the day at 56 or so would give a + 6 point profit. (11% in one trade).

Cup and Handle Breakdowns: High Percentage Chart Pattern

Here we see the opposite our cup and handle breakout on the open, a cup and handle breakdown. Actually, this is more of just a cup... imaging a coffee cup turned upside down, for the price action that you see in the initial part of the trading day. When it loses it's opening price, I look to fire off a a short trade. Let's take a look at an example here with CMCSK:

CMCSK Short: Lost opening price level of 44 1/4 at 10:45am.

2-day support level broken down at 9:45

Our sell/short signal is where we indicate it in the chart to the right. In this case, it would be tough to get a short off if there weren't many upticks to short into. The key is to keep hitting the short button til the tick reverses and you can get your short off. You may have to keep trying to short, punching the short button for 30 seconds or so, until an uptick is made that you can short into.

In this case, since the short signal occurred after 10:30, we can stay in the trade for a bit longer, til right before lunch.

INTC Short: Lost opening price level of 41 at 10:45am.

2-day support level broken when it lost 41.

You'd look to cover the short right over decade support, in this case right over 40.

Again, notice how the stock got some buyers early in the session (you could have traded the cup and handle breakout long on the open, a fast trade til 9:45), then sold off for the rest of the day.

Notice too that the stock is in a technical downtrend, eg lower lows and lower highs. Trade (and in this case, short), with the trend.

Momentum Short Entries: Tanking on Open

Much as with momentum long plays, we tend to avoid these, but, you should be aware of them as one style of shorting that some traders like. (Why do I tend to avoid these? I want a reason other than "the crowd is selling it here" to enter a short, eg losing a 2-day support level lets me know where to put a cover stop loss more easily.

Momentum shorts are more difficult than longs, since you need an uptick to short into. The time to do this is on a "pause", when the initial rush of sellers is taking a breather and the stock is waiting before selling off some more. In the ATHM example below, this pause was at 11 1/8. Do you see it below? We missed the 12 to 11 tank, but getting onboard with the 11 1/8 to 10 3/8 was a bit easier.

ATHM Short: Selling from the open, no buyers in sight.

After an initial pause at 9:40, ATHM kept selling down from 11 3/4 to 11 1/8, paused for a bit longer, then kept selling off to around 10 support. As with longs, you look to find reversals near decade numbers, eg 10 20 30 etc.

Quick self-test: where is the micro-resistance level from the timeframe of 11am til 3 pm at?

Answer: microresistance at 10 3/4... notice it couldn't break over that point though it tested it 3 times during the day.

VERT Short: Here's a more dramatic example. VERT opened up right under 30 and sold off all the way down to 22 or so.

There were three good short entry signals to watch for here:

1) It couldn't make a high above the opening price near 9:30-9:45

2) It was right under 30 decade resistance, a great place to short

3) A second short opportunity cam when it bounced at 10am and kept going down from there.

We'd look to cover somewhere before 20 support level, in this case we got strong support all day long at around 21 1/2...scalps off this support level would be ok too, later in the day.

Homework Assignment: Okay, now you know what to look for - these are the signals professionals use. You won't find them in anyone else's book or website. Homework: I recommend that you use a chart software package, or website like bigcharts.com with 5-day charts, for some of the stocks that you like to trade, and look for similar patterns.

Look for these pro shorting patterns in the stocks that you trade. Notice that NONE of these examples tell you to short stocks that are running up - a common new trader MISTAKE. You want to Sell Weak Stocks and Buy Strong Stocks. Do NOT try to short a shooting star, or buy a falling knife.

These patterns are to help you sell weak stocks at the proper time, for highest short profits. Good trading!

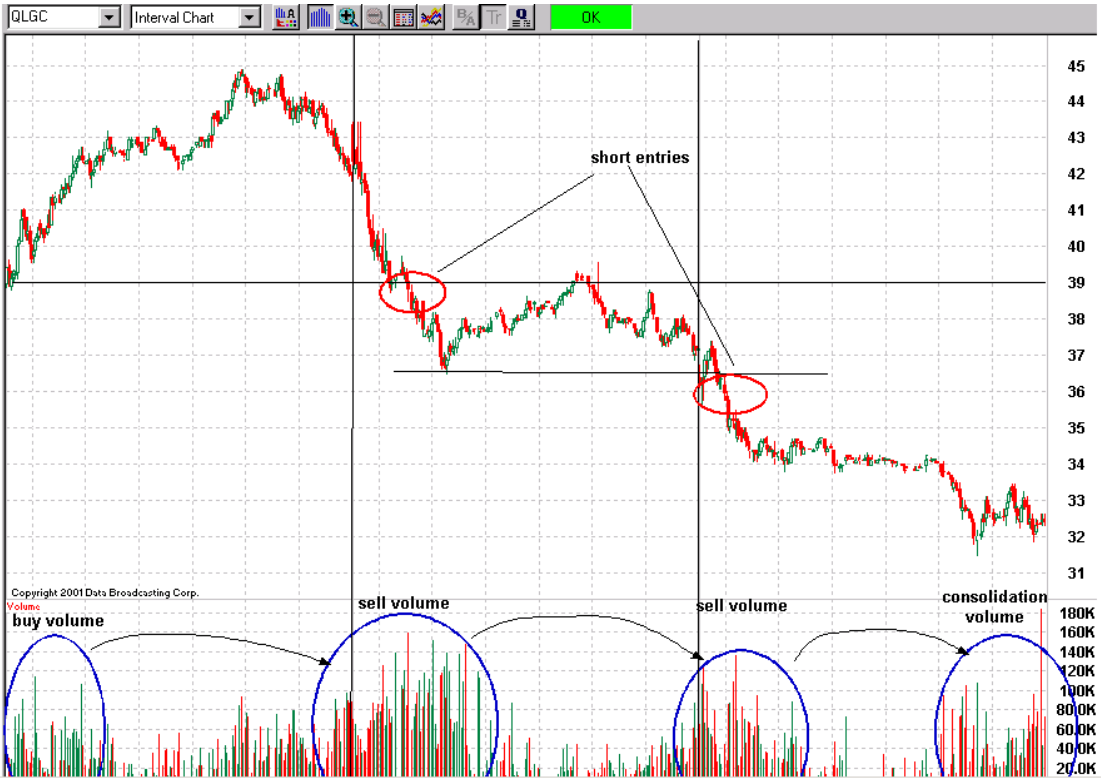
Main Points:

- In psychology, there is a saying that "past behavior is the best predictor of future behavior". In the stock market, we say "bears win, bulls win, pigs become bacon".
- When it comes to repeatable patterns, there are very few, in stock price movements, beyone an initial retest and failure/breakthrough of specific support/resistance areas.
- One thing that does tend to repeat and hold is volume patterns, as in the examples in this lesson. A good example is in the QLGC chart immediately below, the volume is heaviest at the open/close, and thins down from 12-2 daily.
- How do you use this to profit? Buy on similar patterns day to day, eg retest and bounces, or short new breakdowns/buy new breakthroughs, particularly when this volume propels the stock price through a 2-day high or low.
- Be a detective - look for clues in the stock charts, using all your technical knowledge from previous DTU lessons and other books out there.
- Volatility is important as well - see if a stock is exceeding or near it's 2-day trading range, eg if you know KLAC has a 2-3 point trading range and it's already moved 2 1/2 points in one direction on this day, you wouldn't enter in the same direction, unless there's a very (rare) compelling technical breakout.
- Put the probabilities in your favor - make sure to know your stocks, the behavior of the traders in it, as measured by volume and volatility "tracks in the sand" that the stock leaves for you in the previous trading session.

USING VOLUME TRACKS:
Repeatable Early/Late Day High Volume Patterns

Let's look at several days of QLGC in the chart below here. You can see the high volume at the start of each trading day, right? On the first day below, it was all buy volume- a great time to go long. When this started to reverse, we saw short entries. Note that we didn't "guess a top" on the first day, and we didn't short the last third of the range down (from 39-41) on the open of the second day, we instead wait for it to lose the previous day's low, and shorted 38 5/8. The second short entry, on the third day, is again when it loses the previous day's low, short 35 5/8.

What you want to learn here is how to study the charts like this and see what I'm seeing: that "most of the action" occurs on high volume in the first hour or so of the trading day for this stock. This, we know that a short on the third day is likely to continue on downwards, given the volume pattern and 2-day low breakdown. Make sense?



Here's another example to the right (AMGN), that shows us a good short entry under the decade 70 support, on the open of the current trading day, under 69 5/8.

Why? Heavy sell volume on the open drags the price down, and our profits go up, as we short the 69 5/8 on the open, under the two-day low, on heavy volume.

We look to cover (and possibly reverse to a long) once sell volume starts to lighten up, and a cup pattern reversal on heavier volume starts to form. That's our "cover the short" signal, and we're out at 67 3/4 or so for a nice 1 7/8 short profit.

EXTR Short: Here's an excerpt of 3 trading days in EXTR.

Let's scan it for major patterns first:

Support line at the 21.

Heavy volume sellers on each of the two openings shown here.

We short on the start of the third day, as we get our new low, under the 21 and again under the 20.

You see heavy volume on the open of each day, right?

You also see heavy sell volume on the close of the first day, right?

This tells us the market is in a "sell this stock" mode... so, we nab two good short entries on 3/8/01 on the way down.

Finally, we have CMRC - you can see the first entry was a bit tough to catch, as we want a new low, under a whole number, meaning our short entry is at the 15 5/8.

It consolidates for awhile, then sells off on down to 13.5, never once stopping us out.

This is a good short, good for multiple points.

One clue is the volume, it's much higher on the sell side on 3/8/01 than it was on 3/7/01.

Also, you can see CMRC sold on the open of the previous day as well, another hint that this is a "stock to short".

Module Five

Shorting Skills for Active Traders:

PREVIOUS NEXT

Back to MODULE 5

- **TA for Shorting #3: Using Stochastic Reversals to identify short opportunities**

Main Points:

- Remember that we use several types of indicators in daytrading: those called "OSCILLATORS" (eg stochastics, futures, $COMPQ) and "TREND" indicators (indivdual intraday 1-min. candlestick charts, nas composite, sector charts)
- As an "oscillator" type indicator, remember that stochastics give relatively FAST trade signals and we use them, like all oscillators, to indicate REVERSALS and PIVOTS: when to enter a long trade on a bounce, or when to sell a profitable open position as it starts to drop
- IMPORTANT: Note that using stochastics for shorting stocks that have shown recent strength is ONLY for experienced traders. In general we want to short stocks that are losing key support levels vs. shorting these stochastic reversal "tops", which is more risky. **Experienced traders only should use this method**, others are advised to short stocks that are losing 2-day support levels using your 1-minute candlestick chart patterns.
- HOW to READ Stochastics: the only time you pay attention to stochastics are when the two lines, %K and % D, are **crossing over each other either above 90** on a downturn, **or below 10** on an upturn. So, they've either gone above 90% and are now headed downwards, having just crossed over each other (time to sell/short), or have dropped to below 10 and are just now crossing over and headed back up above 10 (time to cover short/buy long).
- Drawback to stochastics: more than other indicators, they may give false buy/sell signals, since they move relatively fast. You can experiment with stochastic settings, I like 15/5 (use 15, slow stochastics, in esignal.com, as below). So, you use them as a secondary, confirming indicator in your trades, along with other things like the $TRINQ, time & sales, level 2 and chart pattern prior to entering or exiting a trade.

How to Short Using Intraday 1-Minute Stochastic Reversals

For shorts that you enter early in the session, either 9:30am open gap shorts or shorts during the morning's 10-minute reversals, we may get a stochastic crossover early enough to help us, as in the chart below. When you see the stochastic lines both go up strongly with the stock price and then start to reverse, we can look to enter a short, once the stock price has started to head down. Always have a close cover stop loss, no more than 1/4 point.

BVSN Short: Loking at the stochastics here, we see they gave us an "overbought" pop signal where the pink line is, they are over 90% and crossed over. The stock price made a top right after this and headed back down.

You would wait until the stock has lost a key support level, eg 29, and enter the short at say 28 3/4 after it's made it's first peak. You would watch carefully to see if there was support at 28 whole number, possible cover there and reshort once it loses 27 3/4... repeat the short until the stock price consolidates & stablilizes in a range to cover.

Stochastic pops are used to define "overbought" conditions in the stock price.

What is the key chart pattern we use? Cup breakouts. In the case above, we see the stock made a "bear cup" from 28 to 29 1/2 and back down to lose 28 (short signal right under 28), a conservative entry.

Experienced traders would short the stochastic reversal pop looking for it to lose 29, after the first stochastic top, and short at 28 3/4. Both strategies worked in this example, for +1 gains.

Traders' Plays - What to look for in stochastic short trades:

- Practice identifying when the stochastics indicate "overbought" (>90%) and "oversold (<10%). If you see too many wiggles up and down past these points, readjust your software til you get clean signals, eg the %K and %D settings, on a one-minute candlestick intraday chart.
- You look to short the reversals in stochastics that get over 90%, also using whole number resistance to your advantage, in combination with Level II, to time your entries.

Trader's Pop Quiz: Using this ALTR chart, identify where you would enter short trades. Use a piece of paper held over the chart (slide it from left to right) to simulate the trading day... When do the stochastics indicate overbought/oversold?

- Where would you first look to go short?
- How would you manage the trade? What order routing option are you most likely to use? Pull up a level II window and look at the participants on the inside bid, who & how would you route a sell/short to them?
- Where would your cover

stop loss be for each trade entry? What's the key support/resistance levels you will use?

In the chart above, note that we have a sharp spike in the stochastic, as with any sudden move in an indicator, it is prone to a fast reversal. Also, notice that sometimes the stoch's can lag and not be as helpful, as in the "late crossover/short signal" we have in the second stochastic rise above.

Using Stochastics with Other Indicators: What's Most Important?

Do you get confused by how to use all the indicators together in a system, properly? I get many questions on this topic - with so many indicators, how do we judge the relative importance of each in our trade decisions, and how do we use them as a system? This area will help you, in using stochastics properly.

AAPL Open Short: Lost opening price level of 21 1/2 at 9:45am. Note that it would be very difficult to get an uptick to short into if you waited until the stock started to break down in this case. The solution? Be ready to keep hitting your 'sell/short' button repeatedly until you get an uptick, say 10-15 times, spaced a few seconds apart each time (don't chase though).

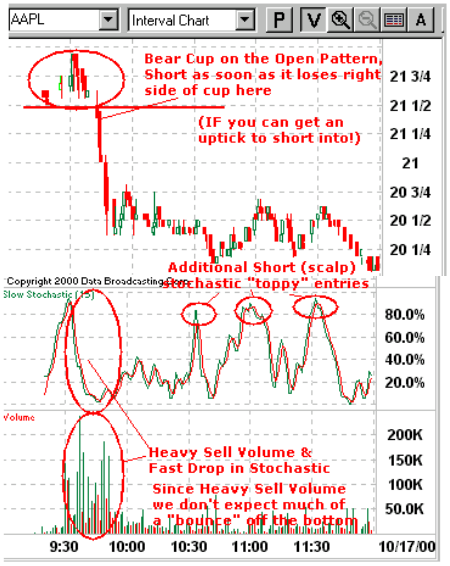
Relative importance of indicators:as an oscillator, you **give stochastics secondary importance** (unless you're a scalper, in which case they're very important)... in determining whether or not to enter a trade.

The main thing to look at is the chart pattern, the $TRINQ, the sector indexes, and the time & sales for your stock.

The stochastic and level II is always of secondary importance. This does not mean you do not use it, on the contrary, you want to see the stochastics reverse to the downside over 90% for a short entry if you're shorting a top. You're looking to have as many indicators tell you the trade is a good one as possible, and react before "the crowd" does.

I find you usually do have at least a couple minutes to get a good trade off before the crowd catches up. Part of this is my using 1-minute charts. If you're using chart support/resistance patterns and time & sales correctly, you do not, contrary to what some people say, have too much noise.

In fact, I depend on having more information, faster, than other traders, to help me make winning trades consistently. I know how to mentally filter out non-important information, so, I like the 1-minute charts. U



Using Stochastics Like a Professional:

1. Make sure to experiment with your %K/%D settings on your 1-minute chart to get an optimum setting. Different stocks are best traded with different settings at times. My default is 15/5.
2. Practice integrating signals from your stochastics with your chart pattern and market indexes, like the $COMPQ and $TRINQ.
3. Be decisive on acting as soon as you get a confirming 10/90 crossover signal from the stochastics. They move fast, and as an oscillating indicator your goal as a trader is to use them to rapidly help you fire off correct trades.
4. Be fast to take stop losses when you are wrong, we always advocate 2-3 spread stops for daytrading, usually 1/4 to 3/8 point.
5. I use stochastics primarily as exit criteria vs entrance criteria for longs, eg when the stochastics start to go over 90 then head downwards, I will be likely to sell out a profitable long position and look to enter a short if it's right under a key resistance (eg whole number/decade number) level.

Practice using stochastics as part of your trade setup. I put them on my large intraday (1/2-day 9am - 12noon) chart, only. Do not put stochastics, volume and other TA indicators on a lot of small thumbnail charts, it clutters them. Focus in on a specific trade by putting the ticker in a large, full-monitor size intraday chart, that has all your technical indicators on it. Good trading with it!

Sector Shorting: Identifying Weak Stocks in Weak Sectors, Using lead/follow stocks

Main Points:

- You know from previous lessons how important it is to look at broad market indicators like the COMPQ and TRINQ, along with sector charts, to **identify relative strength and weakness among sectors** that are diverging each day.
- In this lesson, we will look at how you can **use the divergence in sector charts to recognize good short trading opportunities**, as some sectors are always weaker than others each day.
- I follow the $GIN (Internets) $SOX (semis) $GHA (hardware) $GSO (software) $GIP (networkers) $IXTC (telecoms) and $RLX (retailers), $IXBT (biotechs), for example.
- Learn to recognize variation in chart patterns among these sector charts. You should use **1-minute 1/2 day close line charts** to follow the various sectors. At first, choose only 2-3 sectors to watch, say the $GIN $SOX and $GSO/
- **By variation in chart patterns**, I mean look for the following: a) one sector chart making a faster bear cup than another chart b) sector chart percentages lower for one sector than another for the trading session so far c) chart pattern weakness and strength, as seen by "how high are the bounces compared across sector charts" as they map out during the morning, from 9:30 on.
- After you **train yourself to recognize the variation**, we look to trade based on relative strength and weakness. You know, of course, to be following the tier 1 "Lead" stocks within each sector, at least 2-3 per sectors (eg $GIN: EBAY YHOO, $GSO: MSFT ADBE $SOX: INTC) etc.
- **We look to short stocks that are in the weakest sectors each morning**, in realtime, as we see them being traded. If the whole market is pretty much flat (eg sector charts within a 1% trading range) but the telecoms $IXTC are weak, we go look to short stocks in that weak sector, eg WCOM and other telcos.
- You **trade based on what the market is telling you**; if it's saying "there's no buyers in this sector, everyone's dumping it and rolling their money into another sector" etc, then you can look to short stocks in that sector, during the initial selling.

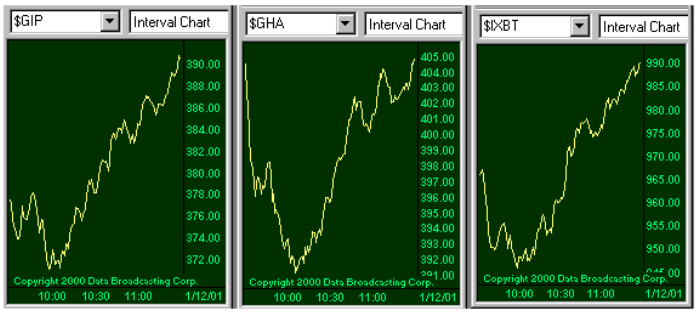
Sector Shorting: Using Variation in $GIN $SOX and others to ID short sectors

You should have at least 2-3 1-minute 1/2 day close line sector charts open in your trading station so you can follow the relative strength of the various sectors, as illustrated below.

These sector charts show roughly equal weakness, telling us that it's a "short any sector"-type day.

Sector Chart Variation

Many days, however, you will see variation among the sector charts, and some will appear weaker than others. An example is found below. These are 3 relatively strong charts, none of which we would short stocks within. However, one sector is weaker than the other two: which is it? And Why? (this is important for you to understand)



Answer: the $GHA sector is weaker than the other two, as it is just now testing it's high of the day, just now completing a bull cup, while the other two $GIP and $IXBT sectors made bull cup breakouts much earlier in the session, at 10:30. Can you see this? What does it tell you?

That stocks in the $GHA (hardware, eg DELL, AAPL) sector are weaker than other sectors, and would thus be more likely short candidates when the market reverses to the downside. Of course, the best days to short are like those found in the 5 sector charts above, where the broad market is selling off.

Go with the overall trend, using sector chart variation to 'lead the way', and alert you to the best groups of stocks to look for shorting.

Sector Percent Change: Watch This!

It's very important that you make this a regular part of your toolkit: a small quote box that has only the COMPQ and major sector percentages in it.

This gives you a very useful, handy reference for which sectors are under- and over-performing the COMPQ, and what their relative ranking is, minute by minute throughout the trading day. Powerful - use it.

This chart tells us that internets are the weakest today, down 7% (wow), while retailers were off 2.3%.

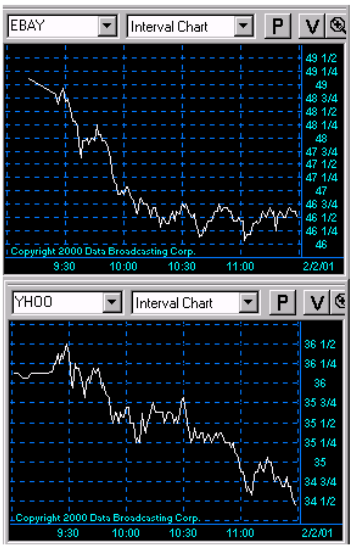
Symbol	Pct
$GIN	-7.0%
$SOX	-5.4%
$GSO	-5.4%
$GIP	-5.3%
$IXTC	-4.6%
$COMPQ	-4.4%
$GHA	-3.6%
$IXBT	-2.3%
$RLX	-2.3%

Lead Stocks within Each Sector Provide an Early Indicator

Following the "lead stocks" in each sector is important, as they get the bulk of the money earlier than others do within the sector, and can be thought of as sector-specific futures (almost!), as lead indicators.

What this means to you is, you may watch a lead stock like EBAY or YHOO (tier 1) and trade a tier 2, smaller cap stock like PSFT DCLK RNWK in the same sector, based on what the "lead stocks" in the sector are doing.

This is an important trading concept to "get right" as well. In shorting, we look for 2-day breakdowns after 9:40 as a key entry point, also after 10am tops are put in and again near 10:30 (where we'd cover on down days, or at least, tighten up our trailing stops).



2-Day New Low in the COMPQ = Great Time to Short

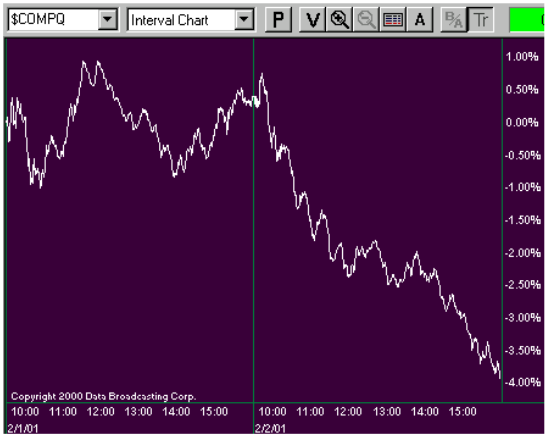
OThe trend's your friend, right? Well, just as we seek to buy 2-day breakouts to the upside for new long positions, we also look to:

Short stocks when the COMPQ is making a new 2-day low. This occurred right after 10:10 or so on the 2-day chart to the right, on 2/2/01.

After lunchtime choppiness (expected), the market continued selling down throughout the rest of the session.

Food for thought: what would you have done if the COMPQ started to head back up through it's two-day low in the afternoon session, if you were trading at that timeframe?

Answer: look for long bounce plays, of course, especially from within sectors that did not sell down as hard as the others.



Main Points:

- There's several shorting errors that new traders are prone to make that I want to show you how to avoid.
- As you go through the examples, look for things that would separate the professional traders from amateurs, both in their use of proper risk management and in using the chart patterns.
- Shorting is primarily for more experienced traders, and is not recommending for first-year traders to try.
- This is not to say you should ignore shorting, it's important that you eventually be able to short as well as go long, so you are making money on both sides of the mountains, the valleys, that occur in stock trading.
- If you make mistakes in your trades, be sure to document the chart pattern and 'what went wrong'.
- If you take a small stop, eg less than 3/8 of a point, that's normal. If you take a large stop, over 1/2 point, something's wrong, and you need to pause and evaluate why.
- Much of what you find in the way of errors are simple mistakes, eg not trading the chart patterns correctly.
- Other mistakes may be due to order routing errors, eg trying to short via SNET when only ECNs are bidding.
- Also, you want to use level 2 in your shorting, but again, not as the primary decision making tool. Your chart patterns are what you use in all trading, level 2 is used to help manage cover stops and order routing, that's it.
- Learning how to use time & sales effectively is also key to good trading, as it shows you the trade-by-trade sentiment in the stock.
- Being too slow is also a common enough error that new traders make. Daytrading is a fast game, you need to hone your reflexes for it. That's why I say shorting is for experienced traders only, as you need to get both shorting into the uptick correct, as well as your chart analysis and risk management.
- Here's a few common errors and mistakes you want to check yourself for prior to trading short:

Avoiding Common Shorting Errors & Mistakes

Error #1 To Avoid:
Failing to Observe the Technical Signals.
Example: Shorting an Open Gap Down

Remember our basic trading guidelines - you want to play off extremes.

Buying gaps down, on confirmation of buyers, is the right play. I'm much more leery of shorting a huge gap down, eg over 8-15% down on the open, as it will often attract buyers.

So, you do not short an open gap down, that's as bad as buying an open gap up, for a gap and trap.

You need to look for cup pattern reversals following a gap, and play the trade according to the major trend for that day, since the stock opened.

In our live trading room, we nailed this one long over 36 3/8 for good profits. (a competitor's room had their traders take a 3 point loss telling their traders to short the gap down!).

Professionals trade early, with the trend, on confirmation signals, as I teach you to do.

Error #2 To Avoid:
Going Against the Primary Trend
Example: Shorting a Momentum Runner

This is the same as trying to catch a bottom, a falling knife, without any reversal confirmations.

New traders will say "It looks expensive here at 32, it already ran up 2 points", only to see it go up another point and a half, as in this GSPN example.

Remember, we need technical signals for all trades. Trying to 'catch the top' of a momentum runner is poor trading.

Good traders will wait for it to consolidate a bit, then lose a key support level, before firing off a short.

Do not guess where the top of a big runner is for shorting. Wait for a confirmation pattern on these.

And, these should only be attempted by very experienced traders. It's much better to short a new 2-day low on the way down than it is to try and short the top of a stock that's just ran up a lot.

Error #3 To Avoid:
Failing to Short a 2-day Breakdown
Example: Watching vs Shorting a 2-day low

Remember to not get 'paralysis analysis' if you see a solid entry on a technical signal like this one.

The stock, JDSU, is making a 2-day low breakdown under 37. We short it at 36 5/8, and look to cover around 34 for a nice profit.

2-day breakdowns are good to short into, generally speaking, so be prepared to recognize and trade these powerful short patterns when they are available for you.

Short Daytrading Basket Trading Worksheet

Goal: Be able to Scan and select stocks that are good for intraday shorting

Instructions: Scan for stocks each day, and weekly, that fall into each of the three categories below. Use this to improve your ability to execute winning short trades.

Open Short Example Types:	***Stocks Meeting This Criteria:***	Papertrading Results for Each Type: Your Net Profit/Loss
Stocks that Are Making New 2-day lows:		
These are the best types of shorts: look to short stocks that are making new lows, under the previous day's low, after 9:45am or so. Short under whole number resistance, eg at 3/4.		
Open Gap Up Shorts >15% w/volume >40K:		
Slightly riskier, look to short stocks that make a reverse cup pattern on an open gap up of over 15%, short around 9:40-10am.		
Shorting the reverse side of a momentum runner:		
These are generally **not** recommended, for very experienced traders only, short a stock that is in a mini technical downtrend after running up over 12-15% during the first hour of the trading day and is now reversing. Note that is has to be making a lower low/lower high pattern after making a top. Use close 1/4 point stop cover loss max on these.		

Short Trading Journal

Directions: Use this sheet to help you identify the type of short you would make, as well as timing for short trades, compared to when the actual best (approximate) times to short/cover would be.

Ticker	Date	Type of Short (2-day low, gap up...)	Time I would have Shorted it:	Actual Best Time to Short It?	Time I would have Covered?	Actual Best Time to Cover?	P/L
ALTR	11/23	making 2-day low	10:05	10:18	10:28	10:28 (ok)	+3/4

Finding Support and Resistance for Shorts

Goal: Be able to improve your trading entry and exits by correctly using support and resistance levels

Complete this worksheet to help you identify chart pattern support/resistance levels for shorts.

Example 1: RNWK

On the RNWK chart to your left, draw in the following:
1) Early morning consolidation area (circle it)
2) Support level in the morning (horizontal line)
3) Correct short entry
4) Correct short cover area

Example 2: EXDS

On the EXDS chart to your left, draw in the following:
1) Early morning consolidation area (circle it)
2) Support level in the morning (horizontal line)
3) Correct short entry
4) Correct 1st short cover area
5) Second support area (horizontal line), and 2nd short

Example 3: SUNW

On the SUNW chart to your left, draw in the following:
1) 2 day support and resistance areas (horiz. lines)
2) Correct short entry (intraday, horiz. line)
3) Correct short cover area (above 2-day support)

Putting it All Together: Your Shorting Trading Plan & Skillbuilding

Your Daytrading Short Game Plan:

What stocks will you plan on looking for shorts in, on a regular basis (your "core shorting basket")?

Tickers:

What types of short trades do you think you'll try to do, primarily? (circle)

- Losing 2-day support (best)
- Intraday range shorts (ok)
- Shorting momentum tops (risky, for pros only)
- Other: _____

Notes:

Short Risk/Trade Management Plan:

What stop losses will you use, Maximum, per trade (circle)?

- 1/8th - 1/4 point (close trading, scalping-style)
- 1/4 point (two-spread cover stops)
- 3/8 - 1/2 point (wider stops)
- 1/2 point or more (do NOT do this!) Keep all stops < 1/2max

How Many Shares Will you Short in each trade (circle) ?

- 100 shares (best for new traders, and for learning)
- 200-300 shares (after you've got some practice and are doing >50%)
- 300-500 shares (average daytrading size, after you're doing well)
- >500 shares (for experienced, pro traders only)

Which of these Shorting MISTAKES will you AVOID (circle) ?

- Trying to guess tops and short momentum runners making new highs (only highly experienced traders should attempt these types of shorts)
- Shorting too many shares at first, over 300/trade, in your first 50 trades
- Trying to short stocks that your broker doesn't have short shares for
- Shorting without clearly understanding the best Order Routing choices for you to cover with (I prefer ISLD and SOES limit orders)

Activities

Module Five: Activity 1 - "Your First 10 Open Shorts"

- This activity will help you learn to correctly identify which stocks are good for open short plays.
- Remember, **open short** means it's a stock that you enter a short sell trade for from **9:30-9:45** or so.
- Use a link like this one to see the day's %gappers. Your "screen" should be for stocks that have **gapped up over 20-30% on premarket volume of 40K shares or more**, and are starting to sell off on the open. A cover stop loss should be no more than 2-3 spreads up from your entry.
- You can also look to **short % gainers at around 10am** or so, look for stocks with at least 500K volume that are up over 20-30% on the day for these.
- The other "screen" is for stocks that have **gapped down 3-5% on the open and are making new 2-day lows**.
- You will soon learn that setting your stop losses and profitable exit targets is the Most Important part about shorting, just as with any trade.
- For this open short practice activity, I want you to **keep track of your profits and losses** on the 10 trades so you can see how you'd do in a live trading situatation.
- Please note that I have a reason for setting the criteria I do - **do not make exceptions** on the rules (eg do not consider an open short on thin volume, eg under 10K volume, to be significant) ... Try my techniques with discipline and see how well they work for you.

Stochastic reversals are also helpful in looking for timing open short opportunities.

Look at WCOM here, the stochastic peaked and reversed, along with WCOM's price... the short signal was when it lost 23.... a cover right over 22.

The GOAL for this activity is for you to learn how to successfully IDENTIFY GOOD OPEN SHORT trading opportunities, using current examples.

Directions - Papertrading 10 OPEN SHORT trades:

1. **Over the next 10 trading days, I want you to look for a total of 10 "open short" plays that meet our criteria for practice trading. (you may find 2 on one day, 3 on another, none on another etc).**
2. Paper-trade how you would enter and exit these "open short" plays based on the guidelines that we have presented here.
3. Open shorts are typically entered around 9:35-9:45 and covered by 10am or 10:15am at the latest. Remember the first 60minutes makes reversals every 10-15 minutes and you want to be on the right side of these in both your long and short plays.
4. Your cover stop losses can never ever be higher than the opening price was at. In the WCOM example above, thats at 24 1/4... Eg you enter the short at 23 3/4 and have a cover stop at 24 or so...
5. **Keep track of your open short profit/loss for the 10 trading days** that you are papertrading these open shorts on.
6. Most importantly, make a brief list of what went right for your profitable open shorts and what you should have done differently for the ones that you lost on. What changes will you make in your personal trading style based on what you've learned?

Activities

Module Five: Activity 2 - "Making Shorts a Regular Part of your Trading Activity"

- This activity will help you learn to **gain confidence and familiarity with the whole idea of shorting**, and help structure several practice activities that should help you become more skilled at it.
- The first thing to do, of course, is to heavily practice it, with a simulator, like the excellent cybertrader.com simulators. If you have an account with them, you just use "demo logon" and still practice trading with live data. If you're not a customer, you can practice with practice data. Or, use whatever simulator you feel comfortable with, just practice.
- Let's look at how to get started on the path to shorting stocks.

First, you must realize the Value, the Benefits of shorting stocks.

This RIMM chart is a great example. One of our TTO traders told us about the long run, I had us wait, and short it on the way fown, at 38.7, to cover for a nice +1 gain.

Ever miss a "run up" in a stocks? For experienced traders, you can short a pivot on the way down, like this RIMM trade. **New traders, short weak stocks making 2-day lows.**

Second, you need to get familiar with the uptick rule, and look for short opportunities based on the chart pattern and time & sales.

Finally, you need to practice, practice, practice, til shorting becomes second nature. Papertrade extensively.

It's the "other half of the action" and you shouldn't miss out on it, once you've been successfully trading long for awhile.

Give it a try!

The GOAL for this activity is for you to gain CONFIDENCE and FAMILIARITY for shorting opportunities, using current examples.

Directions - Papertrading Shorts for 4 weeks during the first 2 hours of the market:

1. Over the next 20 trading days, I want you to decide on **4 stocks** that you will follow and look for shorting opportunities in for the **10am til 11:30am (only) timeframe.**
2. **Next, practice shorting** only stocks making new 2-day lows. These are the best opportunities for new traders to focus in on. If you're more experienced at reading time & sales, you can try pivot shorts like the RIMM example above.
3. Paper-trade how you would enter and exit these short trades. Make sure that you see an uptick in your L2 box prior to entering a specific practice short entry, since you must have an uptick to short into.
4. **Keep track of your practice short trades (how much did you profit/stop out on) and the total profit/loss for the 20 trading days** that you are papertrading these shorts on.
5. Finally, print out the charts of the winning shorts that were good for the most profit, and make a brief list of "what went right" for these shorts. Examples can include: weak market, COMPQ making 2-day low, you shorted a weak stock in a weak sector that day, time of day was good for a short, stock was making a new 2-day low etc.
6. To gain confidence, practice until you are consistently making winning trades. Take several months to do this, do not be impatient. Like all trading skills, this one takes time to master - Best wishes!